NYS SOCIETY OF CPAs
NYSSCPA

November 8, 2021

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

By e-mail: director@fasb.org

Re: Proposed Accounting Standards Update—*Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

(File Reference No. 2021-005)

Dear Ms. Salo:

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 21,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above-captioned exposure draft.

The NYSSCPA's Financial Accounting Standards Committee deliberated the proposed accounting standards update and prepared the attached comments. If you would like additional discussion with us, please contact Sean C. Prince, Chair of the Financial Accounting Standards Committee, at (646) 231-7285, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

Rumbi Bwerinofa-Petrozzello
President

Attachment

NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

PROPOSED ACCOUNTING STANDARDS UPDATE—*FAIR VALUE MEASUREMENT (TOPIC 820): FAIR VALUE MEASUREMENT OF EQUITY SECURITIES SUBJECT TO CONTRACTUAL SALE RESTRICTIONS*

(File Reference No. 2021-005)

November 8, 2021

Principal Drafter

Sean C. Prince

Contributing Drafters from Other NYSSCPA Committees

Christina K. Catalina – Private Equity and Venture Capital Committee
Joanna Conte – Investment Management Committee
Jonathan J. Tang – Business Valuation and Litigation Services Committee

New York State Society of Certified Public Accountants

Comments on

Proposed Accounting Standards Update—*Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

(File Reference No. 2021-005)

We welcome the opportunity to respond to the Financial Accounting Standards Board's (FASB or the Board) invitation to comment on Proposed Accounting Standards Update—*Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* (proposed Update).

General Comments

We support the Board's objective to provide clarity in this area. While we generally agree that the Board's proposal is consistent with the existing fair value measurement framework in Topic 820, we believe the resulting accounting outcome under the proposed Update would not properly reflect economic reality. As a result, we recommend that the Board amend Topic 820 so that contractual sale restrictions are incorporated into the fair value measurement of equity securities subject to such restrictions.

Please refer to our responses to the proposed Update's questions for respondents for further detail about our concerns, as well as our proposed recommendation.

Questions for Respondents

Question 1—Restriction Type: Do you agree with the Board's decision on scope to include all contractual restrictions that prohibit the sale of an equity security? Please explain why or why not.

Response: We agree that the scope of the Board's project should include all contractual restrictions that prohibit the sale of an equity security and not be limited to specific types of contractual sale restrictions, such as underwriter lock-up agreements. Said differently, we believe any final guidance resulting from this project should result in consistent application across all types of contractual sale restrictions and not be limited to certain types while excluding others.

Question 2—Measurement: Do you agree with the Board's decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not be considered in measuring fair value? Alternatively, should the Board amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale restrictions would be required to be considered in determining fair value?

Response: While not a unanimous view,[1] the overwhelming majority of our committee members do not agree with the proposed Update that contractual sale restrictions should be ignored when determining the fair value of the equity security subject to such restrictions. While we acknowledge that the proposed Update is consistent with the existing fair value measurement framework in Topic 820 (i.e., under which items that are considered characteristics of the holder of the asset are excluded from fair value measurement), we do not believe a fair value measurement that ignores the existence of the contractual sale restrictions would reflect the true economic value of the equity security. Consequently, we recommend Topic 820 be amended such that contractual sale restrictions would be required to be considered in determining the fair value of equity securities subject to such restrictions.

In support of this recommendation, we share the following observations with the Board:

- In an overwhelming majority of the circumstances we have observed, reporting entities that hold equity securities subject to contractual sale restrictions are currently incorporating the effect of the restriction in their measurement of fair value. Contrary to the circumstances implied in the proposed Update, we have not observed significant diversity in practice as to whether or not such restrictions are incorporated into the fair value measurement. Rather, the area of diversity tends to be how much of an effect the restriction has on the fair value measurement. This observation holds true for both investment companies as well as non-investment companies. We refer the Board to the AICPA Guide on *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*, which specifies that securities subject to a contractual sale restriction should be considered a characteristic of the asset (see paragraph 13.12). This guidance was released in 2018 and has been widely adopted by industry.

- We agree with the alternative view presented in the proposed Update that "the distinction of whether a legal or contractual restriction on a sale is asset specific or entity specific is arbitrary from an economic point of view because the value of an equity security can typically only be fully realized through sale." Furthermore, this "distinction is not particularly meaningful because the restriction precludes transfer of the asset and, thus, a determination of whether the restriction would transfer with a sale of the equity security is only hypothetical." We believe a market participant would be unlikely to make a distinction between contractual

[1] Some committee members support the proposed Update. While they acknowledge that the contractual sale restriction affects the fair value of the security, they do not believe the benefits of incorporating the restriction into the fair value measurement outweigh the costs. Further, they believe that neither fair value measurement—one that incorporates the restriction or one that doesn't—is better than the other because, ultimately, the holder cannot sell the equity security at either price. They also believe disclosure of the restriction, rather than an attempt to quantify the hypothetical effect of the restriction on the value of the investment, is the better alternative. In addition, the Proposed Update has the benefit of reducing diversity in practice and reducing the cost and complexity in application.

sale restrictions and legal restrictions since there is little difference in the economic effects between the two.

- We also support the opinions expressed in the alternative view regarding the resulting disconnect between "economic fair value" and "accounting fair value" under the proposed Update. Equity securities subject to contractual sale restrictions are subject to different risks when compared to equity securities that are not subject to similar restrictions and these risks have a real impact on economic fair value. We believe an approach that ignores these restrictions also ignores the fact that the price of the unrestricted equity securities is also generally "artificially" higher than it otherwise might be due to the contractual sale restrictions in place. Having to use such a price to value the contractually restricted securities would further exacerbate the difference between economic fair value and accounting fair value. More specifically, not recognizing the potential economic impact of contractual restrictions will increase the risk of overvaluation of these securities. This may result in inaccurate financial statements, misstated financial ratios, insufficient collateral for loan covenants, and other potential complications.

- Academic research shows that traded stock prices are affected by the status of contractual lock-up periods. Specifically, stock prices tend to drop significantly at the expiration of lock-up periods due to an increased supply of available shares, even though the expiration dates are known and included in company filings months in advance. As stated in the alternative view section of the Proposal, holders of securities affected by lock-up provisions are also prohibited by the same provisions from hedging their market exposures until the expiration date, further increasing the negative economic effects of the lock-up provision.

- The guidance in the proposed Update would have real economic consequences to investors. For example, in the context of investment companies, ignoring the contractual sale restriction could result in artificially inflated investment valuations and overstated net asset values. As fees charged to investment companies by investment advisers are generally based on asset valuations or performance, the Board's proposal could cause investors to be overcharged in relation to the true economic value of the underlying assets of the investment company. Additionally, for funds that permit periodic investor subscriptions and redemptions, there is a risk that redeeming investors could be paid out based on investment valuations that are not realizable by the investment company in the principal market, as well as the risk that subscribing investors could subscribe at prices that are overstated in comparison to the true economic fair value of the underlying assets held by the investment company. Overvaluations could also affect reported performance metrics.

Based on the above observations, we recommend the Board amend Topic 820 so that contractual sale restrictions be considered in the fair value measurement of equity securities subject to those restrictions for all types of entities.

Question 3—Entity Type: Should all types of entities use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction, or should certain types of entities (for example, investment companies, broker dealers, and pension plan financial statements) have a different unit of account? Please explain your response.

Response: We believe the same unit of account should apply to all types of entities. While certain entities may have access to different markets, and therefore determine a different fair value, the unit of account should be the same.

Question 4—Disclosures: Would qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity? Please explain why or why not. For reporting entities, what costs would be incurred to disclose that information?

Response: We agree that qualitative and quantitative disclosures are beneficial to users. Such disclosures will assist a user in understanding how the restrictions affect the timing of when the security can be transferred or sold and how such restrictions can cause increased risk and volatility in the amount ultimately realized.

Question 5—Transition: Do you agree with the transition guidance in this proposed Update? Please explain why or why not.

Response: As noted in our response to Question 2, we do not believe contractual sale restrictions should be ignored in the fair value measurement of equity securities subject to such restrictions. Rather, we recommend the Board amend Topic 820 so that such restrictions are included in the unit of account when determining fair value.

We acknowledge that some companies historically have ignored contractual sale restrictions in their fair value measurement of equity securities subject to such restrictions. As a result, transition guidance for these entities would be warranted if the Board were to accept our recommendation to amend Topic 820.

In that light, we support the proposed transition guidance in the propose Update. That is, we agree that the transition should generally be prospective in nature. Furthermore, we support a "grandfathering" approach for investment companies as currently drafted in the proposed Update.

Question 6—Implementation: How much time would be necessary to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.

Response: We do not believe the time needed to implement the proposed amendments will be significant. Notwithstanding, consistent with general practice, we would support the FASB providing more time to entities other than public business entities to adopt the proposed amendments.

Question 7—Clarity and Operability: Do you agree that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve existing diversity in practice? Please explain why or why not. Are the proposed amendments operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?

Response: We support the proposed Update's guidance on the fair value measurement of restricted securities. See our response to Question 2 regarding our view on contractual sale restrictions. Otherwise, we believe the amendments are operable and auditable.